

FINAL PRIVATE LETTER RULING

REQUEST LETTER

09-012

May 12, 2009

Pam Hendrickson
Chair, Utah State Tax Commission
210 North 1950 West
Salt Lake City UT 84134

Dear Ms. Hendrickson:

Utah Code Ann. 63M-2-101 is the chapter known as the Utah Science Technology and Research Governing Authority Act (USTAR). This act allows the legislature to fund science technology research buildings on various campuses in the State of Utah as well as funding technology outreach programs to assist higher education in the State of Utah in commercializing research projects for economic development. It also allows the funding of research teams at the various universities. Perhaps you may have read about the funding at the UNIVERSITY 1 this week for a \$\$\$\$\$ research building and for a similar endeavor at UNIVERSITY 2.

It is our understanding that both the UNIVERSITY 2 and receive exemption from the payment of sales tax on construction projects and we would like to request that USTAR be given the same exemption on its construction projects because they serve the same purpose. If the Tax Commission grants such it would greatly assist USTAR as they have begun the construction process and are presently being invoiced. If, on the other hand, the Tax Commission feels it cannot allow USTAR to receive the same exemption as the universities then we will go through the formal process of seeking a 501C3 exemption, but would respectfully request that USTAR be exempted from paying the sales tax on its construction pending the approval of the 501C3 classification.

We very much appreciate your consideration on this matter and if you have any questions you can certainly call NAME 2 at USTAR, PHONE or , at PHONE at the OFFICE.

Sincerely yours,

NAME

WCL/slc

cc: NAME 3
USTAR

RESPONSE LETTER

March 2, 2010

NAME
OFFICE

RE: Private Letter Ruling Request—The Sales and Use Tax Treatment of Construction Materials for USTAR’s Research Buildings

Dear NAME:

You have requested a ruling on whether the construction materials for certain research buildings are exempt from sales and use tax.

Facts

In your letter, you discussed Utah Code, Title 63M, Chapter 2, which is titled “Utah Science Technology and Research Governing Authority Act.” This act authorizes the Legislature to fund certain research buildings on the campuses of the UNIVERSITY 2 and the UNIVERSITY 1. Utah Code Ann. § 63M-2-201. The Utah Science Technology and Research Governing Authority (“governing authority” or “USTAR”) ¹ is required to “plan, design, and construct the buildings.” § 63M-2-201(2). UNIVERSITY 2 and the UNIVERSITY 1 are required to provide the land for the research buildings. § 63M-2-201(3). The governing authority is required to “hold title to the research buildings.” § 63M-2-201(4). Also, “[t]he governing authority may: (a) lease the buildings to UNIVERSITY 2 and the UNIVERSITY 1.”

You explained that the Legislature has now funded the construction of the research buildings on the UNIVERSITY 2 and UNIVERSITY 1 campuses. We assume that the governing authority is constructing these research buildings through contracts with third party, building contractors.

You have requested that the Commission allow the governing authority to receive the same exemption from sales tax on construction projects that UNIVERISTY 2 and the UNIVERSITY 1 receive. You provide that the UNIVERSITY 1 and UNIVERSITY 2 are charitable entities under I.R.C. § 501(c)(3). You assert that the governing authority serves the same purpose as the universities. You explained that if the Tax Commission does not grant this request, USTAR would formally seek the 501(c)(3) designation from the IRS. You have also requested that if the 501(c)(3) designation is required, the Commission rule that USTAR is exempted from paying sales tax on its construction pending the approval of its 501(c)(3) designation.

¹ We observe that the only statutory reference to “USTAR” is under Utah Code Ann. § 53A-17a-159, which identifies USTAR as the “Utah Science Technology and Research Initiative.” Accordingly, we rely on our understanding of your representations regarding the term “USTAR” and the “Utah Science Technology and Research Governing Authority Act.” That understanding is that USTAR as used in this ruling means the “Utah Science Technology and Research Governing Authority.”

Through conversations with Commissioners, you clarified certain issues that you want covered in this letter. They are as follows:

1. *Can USTAR avail itself of the UNIVERSITY 1 or UNIVERSITY 2 tax-exempt status, because it is closely related to those organizations and the expenditures in question will be for the benefit of those organizations?*
2. *If not, is there an alternative basis on which the sales tax exemption can be granted?*
3. *If the only route for state sales tax exemption is filing the IRS Form 1023 application for tax-exempt status, is there any way the Tax Commission could grant the exemption retroactively to an earlier date than the filing date of the IRS Form 1023?*
4. *Can the Tax Commission allow USTAR to forego paying sales tax while the application is pending, with the understanding and guarantee that USTAR will pay all applicable sales and use taxes if the exemption is not ultimately granted by the IRS?*

Based on the analysis that follows, the Commission has determined that USTAR has not been shown to be a charitable organization, and cannot avail itself of the UNIVERSITY 1 and UNIVERSITY 2 tax-exempt status. Furthermore, based on your representations, we do not find an alternative basis to grant a sales tax exemption. There is, however, as you indicate, a basis on which an exemption can be granted. USTAR may request a 501(c)(3) certification from the IRS. Once the application has been made, USTAR and/or its contractors may file claims for refunds on its purchases. Our Taxpayer Services Division (“Division”) will hold the refund requests until USTAR provides evidence of the 501(c)(3) status. If and when that status is confirmed, the Division will process the refund claims in accordance with statute. The statute of limitations will be applied retroactively from the time the refund claim is filed with the Division. The claims must be supported by appropriate documentation. USTAR and/ or its contractors may also purchase construction materials and other tangible personal property tax exempt upon receiving 501(c)(3) status. If the IRS does not grant the 501(c)(3) status, of course the claims would be denied, absent any other evidence to support an exemption. Finally, the Commission will not grant an exemption number nor allow USTAR to forego payment on sales tax while waiting for the IRS to approve the application.

Relevant Authority

Utah Code Ann. § 59-12-103(1) imposes tax on “(a) retail sales of tangible personal property within the state.”

Utah Code Ann. § 59-12-102(26) defines construction materials as “. . . any tangible personal property that will be converted into real property.”

Utah Code Ann. § 59-12-104(2)-(2)(ii) provides an exemption for certain purchases by state government entities, stating in part:

The following sales and uses are exempt from the taxes imposed by this chapter:

.....

- (2) sales to the state, its institutions, and its political subdivisions; however, this exemption does not apply to sales of:
 - (a) construction materials except:
 - (i) construction materials purchased by or on behalf of institutions of the public education system as defined in Utah Constitution Article X, Section 2, provided the construction materials are clearly identified and segregated and installed or converted to real property which is owned by institutions of the public education system; and
 - (ii) construction materials purchased by the state, its institutions, or its political subdivisions which are installed or converted to real property by employees of the state, its institutions, or its political subdivisions;

.....

Utah Constitution Article X, Section 2 defines the public education system, stating:

The public education system shall include all public elementary and secondary schools and such other schools and programs as the Legislature may designate. The higher education system shall include all public universities and colleges and such other institutions and programs as the Legislature may designate. . . .

Utah Code Ann. § 59-12-104(8) provides an exemption for “sales made to . . . charitable institutions in the conduct of their regular . . . charitable functions and activities, if the requirements of Section 59-12-104.1 are fulfilled . . .” Utah Code Ann. § 59-12-104.1 explains how the exemption is administered.

Utah Admin. Code R865-19S-43 (“Rule 43”) provides additional clarification as to the criteria on which an entity is considered to be a charitable institution:

- A. In order to qualify for an exemption from sales tax as a religious or charitable institution, an organization must be recognized by the Internal Revenue Service as exempt from tax under Section 501(c)(3) of the Internal Revenue Code.

Utah Admin. Code R865-19S-58 (“Rule 58”) guidance on how some construction materials may be purchased as tax-exempt, stating in part:

- (1) Sales of construction materials and other items of tangible personal property to real property contractors and repairmen of real property are generally subject to tax if the contractor or repairman converts the materials or items to real property.
.....
- (2) The sale of real property is not subject to sales tax, nor is the labor performed on real property. . . .

-
- (b) Except as otherwise provided in Subsection (2)(d), the contractor or repairman who converts the construction materials, fixtures or other items to real property is the consumer of the personal property whether the contract is performed for an individual, a religious or charitable institution, or a government entity.
 - (c) Sales of construction materials or fixtures made to religious or charitable institutions are exempt only if the items are sold as tangible personal property.
 - (d) Sales of materials are considered made to religious or charitable institutions and, therefore, exempt from sales tax, if:
 - (i) the religious or charitable institution makes payment for the materials directly to the vendor; or
 - (ii) (A) the materials are purchased on behalf of the religious or charitable institution.
 - (B) Materials are purchased on behalf of the religious or charitable institution if the materials are clearly identified and segregated and installed or converted to real property owned by the religious or charitable institution.
 - (e) Purchases not made pursuant to Subsection (2)(d) are assumed to have been made by the contractor and are subject to sales tax.
-

Utah Code Ann. § 59-1- 1401 provides for a party to make a claim for refund, as follows:

- (8) (a) Except as provided in Subsection (8)(b) or Section 19-2-124, 59-7-522, 59-10-529, or 59-12-110, the commission may not make a credit or refund unless a person files a claim with the commission within the later of:
 - (i) three years from the due date of the return, including the period of any extension of time provided in statute for filing the return; or
 - (ii) two years from the date the tax was paid.
- (b) The commission shall extend the time period for a person to file a claim under Subsection (8)(a) if:
 - (i) the time period described in Subsection (8)(a) has not expired; and
 - (ii) the commission and the person sign a written agreement:
 - (A) authorizing the extension; and
 - (B) providing for the length of the extension.

Analysis and Ruling

Before beginning our analysis, we note that you specifically referenced construction projects. Our analysis applies not only to construction materials used in real property construction, but also to tangible personal property, such as furniture, fixtures, and equipment (“FF&E”), which will remain personal property. You have identified four specific issues to which the Commission will respond.

1. *Can USTAR avail itself of the UNIVERSITY 1 or UNIVERSITY 2 tax-exempt status, because it is closely related to those organizations and the expenditures in question will be for the benefit of those organizations?*

USTAR may not avail itself of the UNIVERSITY 1 or tax-exempt status. You provided that the UNIVERSITY 1 and UNIVERSITY 2 are charitable entities under I.R.C. § 501(c)(3), and accordingly, qualify for the exemption found in § 59-12-104(8) for sales to such entities. You base your position on the fact that USTAR's construction projects "serve the same purpose" as those of the two universities. However, there is no provision in statute or rule allowing a charitable exemption to be granted to an unqualified entity simply because that entity has a purpose similar or identical to the purpose of a qualified entity.

USTAR is not a 501(c)(3) organization, nor have you provided any statutory or legal basis for USTAR being considered a charitable organization. Thus, sales of materials for USTAR's construction projects are not exempt under R865-19S-58(2)(d)(i) because USTAR is currently not recognized as a charitable institution under I.R.C. § 501(c)(3).

Additionally, the sales of construction materials are not exempt under the provisions of R865-19S-58(2)(d)(ii), either. If those provisions were met, USTAR could purchase the materials tax-free *on behalf of* the UNIVERSITY 1 and UNIVERSITY 2. However, under the fact situation you have presented, USTAR cannot convert the materials into real property *owned by* the UNIVERSITY 1 or UNIVERISTY 2 because § 63M-2-201(4) requires USTAR, *not* the UNIVERSITY 1 or UNIVERSITY 2, to hold title to the research buildings (the real property). Therefore, USTAR cannot avail itself of the UNIVERSITY 1 and UNIVERSITY 2 tax-exempt status.

2. *If not, is there an alternative basis on which the sales tax exemption can be granted?*

We do not find an alternative basis on which a sales tax exemption can be granted. Section 59-12-104(2) does provide a sales tax exemption for sales to the state and its institutions. However, this exemption allows for only two circumstances in which construction materials are exempt. The first requires that, among other things, "construction materials [be] purchased by or on behalf of institutions of the public education system as defined in Utah Constitution Article X, Section 2." Utah Constitution Article X, Section 2 defines the institutions of "the public education system" to "include public elementary and secondary schools" but to exclude "all public universities and colleges." Therefore, in this situation, the exemption of § 59-12-104(2) (a)(i) cannot apply because the public education system not involved; USTAR is not part of the public education system.

The second circumstance requires that, among other things, "construction materials . . . [be] installed or converted to real property by employees of the state, its institutions, or its political subdivisions." § 59-12-104(2)(a)(ii). In this situation, we assume that USTAR is constructing the research buildings through contracts with third party building contractors. Third party contractors are not employees of the state, etc. Therefore, the exemption of § 59-12-104(2) (a)(ii) does not apply.

We note as well that in general any tangible personal property, such as FF&E, is also exempt under § 59-12-104(2) for sales to institutions of the state. However, you have not provided any indication that USTAR is such an institution. Accordingly we find that § 59-12-104(2) does not apply.

3. *If the only route for state sales tax exemption is filing the IRS Form 1023 application for tax-exempt status, is there any way the Tax Commission could grant the exemption retroactively to an earlier date than the filing date of the IRS Form 1023?*

If the IRS recognizes USTAR as a § 501(c)(3) exempt charitable organization, the Commission will allow the charitable status to be applied retroactively to the time of application. The normal practice of the Taxpayer Services Division is to process refund claims only when an organization has been recognized by the IRS as a tax-exempt charitable organization. In the case of USTAR, however, we find two unique circumstances that distinguish it from other organizations. First, USTAR was established, as you stated, under Utah statute. Second, USTAR's construction projects are closely associated with the two universities, both of which are recognized by the IRS as 501(c)(3) organizations. Accordingly, USTAR may file a claim for refund as provided under § 59-1-1401(8)(a) as soon as it applies for the exempt status with the IRS. Once certification is granted, we will grant qualifying refund claims within the statute of limitations provided under § 59-1-1401(8)(a)(i) & (ii). The statute of limitations will commence as of the date of application for the IRS 501(c)(3) recognition. In short, once USTAR files an application for the certification, it may file a claim for refund on 1) any return due within three years prior to the date of filing the application or 2) any tax paid within two years prior to the date of application.

At this point we need to clarify the specific requirements for purchases of construction materials. Rule 58 provides that sales made to a charitable institution of construction materials are exempt if the materials are sold as tangible personal property. Similarly, the Rule provides under subparagraphs (2)(b) and (2)(d) that a contractor is not the consumer of the construction materials if the sales of the materials are made to a charitable institution. Rule 58 further specifies two instances for the sales of materials to be considered *made to* a charitable institution. First, the charitable institution may pay the vendor directly for the materials. Second, another entity, most likely a contractor, may purchase the materials *on behalf of* the charitable institution, with the materials being "clearly identified and segregated and installed or converted to real property owned by the . . . charitable institution."

In this case we assume most, if not all, of USTAR's purchases of construction materials will be made by third party contractors. This distinction from direct purchases is important. Refund claims for direct purchase are fairly simple; all you need to do is maintain copies of invoices and returns. In contrast, when the contractor pays sales taxes to its vendors for materials used in the construction of USTAR's projects, several steps are required to claim refunds. First, the contractor must clearly identify and segregate its purchases for USTAR's projects from all other purchases it makes. Second, either USTAR or its contractors may file a refund claim. If USTAR requests the refund, it must obtain the original purchase invoices from its contractors. Alternatively, USTAR can arrange for its contractors individually to submit

refund claims, and then remit the refunds granted back to USTAR. Under either procedure, USTAR's claims of refunds must still meet the provisions for all claims of refunds, found in § 59-1-1410(8)(a) and Rule 58(2)(d)(ii)(B).

You may contact TAXPAYER REP of the Taxpayer Services Division at PHONE PHONE for information on how to file refund claims once an application is made and how to obtain a sales tax exemption number if and when 501(c)(3) status is granted.

4. *Can the Tax Commission allow USTAR to forego paying sales tax while the application is pending, with the understanding and guarantee that USTAR will pay all applicable sales and use taxes if the exemption is not ultimately granted by the IRS?*

The Commission will not allow USTAR to obtain a sales tax exemption number while its application before the IRS is pending. The appropriate procedure, as we stated above, would be for USTAR or its contractors to pay the tax at the time of purchase. Then, when an application for 501(c)(3) recognition is made, USTAR can apply for the appropriate refunds. We do not see any way for USTAR to obtain an exemption certificate before it is actually approved by the IRS as an exempt charitable organization. Our position is as much for the benefit of USTAR as it is for the Tax Commission's administrative purposes. If the IRS does not grant the 501(c)(3) status, USTAR would be liable for all unpaid taxes.

Conclusion

In summary, based on our assumptions and your representations, the Commission finds that USTAR does not qualify for a sales exemption. However, given the unique circumstances that apply to USTAR's situation, USTAR may file refund requests with the Tax Commission as soon as it shows that it has applied to the IRS for recognition as a 501(c)(3) tax-exempt organization. The Taxpayer Services Division will hold the refund requests until USTAR is approved for the IRS exemption. Upon receiving evidence that the IRS recognizes USTAR as a 501(c)(3) organization, the Division will begin processing the refund requests and will issue an exemption number.

We have attached, for your reference, copies of Form TC-160, Application for Sales Tax Exemption Number For Religious or Charitable Institutions, and Form TC-721, Exemption Certificate. Also enclosed are relevant portions of Publications 25, Sales and Use Tax General Information, and Publication 42, Sales Tax Information. These documents can also be found respectively on our website at the following URL addresses:

- <http://tax.utah.gov/forms/current/tc-160.pdf>
- <http://tax.utah.gov/forms/current/tc-721.pdf>
- <http://tax.utah.gov/forms/pubs/pub-25.pdf>
- <http://tax.utah.gov/forms/pubs/pub-42.pdf>

Our conclusions are based on the facts as described and the Utah law currently in effect. Should the facts be different from those represented or if the law were to change, a different

conclusion may be warranted. If you feel we have misunderstood the facts as you have presented them, if you have additional facts that may be relevant, or if you have any other questions, please contact us.

For the Commission,

Marc B. Johnson
Commissioner

MBJ/aln
09-012

Enc.

Cc (w/o enc.): NAME 3
Executive Director
USTAR